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Problems of Indian Currency & Exchange

By

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PROBLEMS OF INDIAN CURRENCY AND EXCHANGE

INTRODUCTORY

The Indian currency system has been the most unpopular aspect of British rule and administration in India. It has been at every stage an avowedly transitory system, with little or no claim to naturalness, leaving too much to the decisions of administrative officials who are not responsible to public opinion and thus engendering a great deal of suspicion about the motives behind currency and exchange policies. It is true that some of the features of the Indian system, like the economic use of gold in a gold exchange standard and the maintenance of the exchanges with the aid of special funds in more than one centre, have of late come into wider vogue. But this fact is neither a feather in India's cap nor an index of how the country has been served by its currency and exchange system. The price that India has paid for the dubious honour of pioneering in the field of managed currency is computable only in terms of the funds dissipated in support of unwise policies and not in terms of the setbacks to national economic development and to the solution of the vast problems with which India has been beset. But even so, the price is a huge one. Even when the present war broke out, with the Reserve Bank of India already established, the system was in an inchoate stage, with the Reserve Bank barely able to list and not appraise its main problems. On the top of a "system" which was not the result either of a process of evolution or of a well-planned policy, have been superimposed the special features of the war period such as inflation and the consequent distortion of the price structure.

RECENT TRENDS IN WORLD FINANCE

In the wider sphere of international finance, the period between the middle of the last century and the present has been characterised by such violent changes as the abandonment of bimetallism in the nineties, the disruption of the

international gold standard after the last war, and, at a later stage, the advent of the system of managed currencies with its loose links with gold and its appendage of equalisation funds, exchange controls and control of credit by national central banking institutions. Through these devious paths, the majority of the nations of the world have succeeded in evolving national currency systems which ensure that, within each country, finance serves its true function as handmaid of industry. The correlation of national currency systems into a well-regulated and smooth working system of international finance is, no doubt, rendered difficult in the process. But the task of effecting such correlation is now being essayed assiduously; and clear perception of national needs is, in the long view, a surer help to stability in international finance than heedless subjection of national economic fortunes to irrational and uncontrollable world trends. India is almost alone in the world in having failed so far to secure for herself a currency system fashioned to suit her national needs.

OBJECTIVES OF A SOUND CURRENCY POLICY

With the approach of the end of the war, India has to face the problem of remodelling her currency system with three different but inter-related objectives clearly in view. The first is that the system shall enable the smooth working of a machinery of internal credit, which will ensure the success of plans of economic development on which the people have now set their heart. Secondly, it shall enable the maintenance of the external value of the rupee at a level which will be helpful to our economic development and ensure fair terms of trade between India and other nations. Thirdly, the system should be capable of integration with reasonably sound schemes of international financial regulation so that India will not be exposed to the taunt of non-co-operation in vital tasks in the international sphere.

These three objectives do not suffer from any inherent conflict. It is true that in the past conflicts between requirements of internal progress and of stability of the external value of the rupee have not been infrequent. Yet, given an adequate appreciation of the needs of a backward and undeveloped country like India, they should easily be overcome.

The task of refashioning the Indian currency system to suit the aims mentioned above is not, however, less arduous for that reason. For, when the war will be over, India will have to take up not only the problems which result directly from war finance, but also the problems which, so to say, have been laid up over a whole century. When the war broke out, India was on what was intended to be a gold bullion standard but what had been whittled down to a sterling exchange standard alike by the preferences of official policy and the requirements of the period following the general abandonment of the gold standard. In fact, the Indian system has in effect been a sterling exchange standard ever since the abandonment in 1893 of the monometallic silver standard. Gold had no well-defined place in it. Whether it was as an official pre-occupation, for reasons not difficult to guess, or as a dictate of prevalent conditions, the provision for the convertibility of rupees into sterling and *vice versa* comprised practically the whole of the system. The provision and regulation of internal currency and credit was not only subsidiary to exchange into sterling, but was always determined by the real or supposed requirements of the latter. The question of establishing a monetary standard, which will command the confidence of the people and promote the financial strength and economic progress of the country was shelved at every stage, till the makeshifts that were adopted on a temporary basis revealed the scope for administrative management and manipulation and encouraged the authorities to continue indefinitely the system of managed currency and exchange. Both during the last war and during this, the managed basis of Indian currency has suited the requirements of the Government. Foreign opinion is apt to be influenced by the fact that many of the features of the Indian currency and exchange systems are to-day common to the systems of many other countries. But there is a world of difference between changing a natural system of currency to suit the abnormal conditions of the last one decade and more and keeping a thoroughly artificial system for more than half a century. I call it artificial, not because it was a managed system, but because it did not grow out of the needs and conditions of India. And what is more, it was managed not in accordance with the interests

of India but with an eye to the foreign trade, the external obligations of the Government and the incidental advantages which accrued to Britain from a day-to-day management of India's currency and exchange system.

THE CRITERIA OF A SOUND CURRENCY SYSTEM

The main tests, then, of a sound currency and exchange system are firstly, a monetary standard, secondly, a suitable link with the principal currencies of the world and, thirdly, a structure and mechanism of internal credit the natural expansiveness of which will not be hindered either by the standard of value or by its link with other currencies. On all these three tests, the Indian system must be said to have failed miserably.

THE TRUTH ABOUT INDIA'S HOARDING HABIT

Taking first the question of the monetary standard, it has in the special conditions of India an importance which foreign opinion may not find it easy to appreciate. India is thought all the world over to be a sink for precious metals. Like all generalisations about foreign countries, it is no help, and not a little hindrance, to the understanding of the realities of the position in India. That the Indian masses have an age-old propensity to hoard precious metals need hardly be disputed. So have the French peasants; and in the case of the Indian, the liability to frequent invasions from abroad and dynastic changes in the petty kingdoms and principalities may have coloured the national consciousness. But the Indian masses are known to have parted with gold on a considerable scale on more than one occasion. In the years following the demonetisation of silver, the Government of India did find it possible to build up a gold reserve. During the depression and immediately after the abandonment of the gold standard in 1931 India exported gold to the tune of Rs. 500 crores. It can hardly be said in the light of this that Indian hoarding stood in the way of building up a simple and intelligible monetary standard. On the other hand, official policy may be reasonably said to have strengthened the will to hoard. It is not lost on the popular mind that twice within one's lifetime silver had shot up to dizzy heights and touched some of

the lowest levels in prices. Nor can the public overlook the wide variations in the rupee price of gold. These changes, which are not peculiar to the war periods but have been experienced in peace time also, though to a lesser extent, are to blame, if India has not yet been completely cured of the hoarding habit. At no stage in the history of India's currency during British rule was the monetary standard calculated to inspire the confidence of the public, draw money from the hoards and enable the building of a system of banking and credit capable of developing the vast economic potentialities of this country.

CURRENCY POLICY AND ECONOMIC PROGRESS

While the monetary standard was not helpful to the building up of internal banking, the exchange policy of the Government, which, as has been mentioned already, took precedence over internal credit more often than not, necessitated a deflationary policy at home. It was only when the conditions of internal credit and currency circulation became palpably stringent that the monetary screw was relaxed and additional currency was provided by the process of taking silver from the currency reserves and minting it into token silver coins. The whole process was so thoroughly artificial that it is no wonder that India has more than once during the last few decades been obliged to buy silver in unconscionably dear markets and sell it later at ludicrously low prices. Even in the case of gold, there is the significant fact that, while India exported gold not ten years ago on a large scale, she is to-day buying gold back at twice the former price. Here it is important to note that the volume of credit and currency depended unduly on the discretion of the authorities charged with working a thoroughly artificial system. What with deflation and the well-known effects of a high exchange on a country's trade and industry, the Indian currency system has been the most powerful regressive force in the economic life of India.

THE EARLY PATTERN OF INDIAN CURRENCY—LACK
OF A UNIFORM STANDARD UNTIL 1835

A brief historical retrospect may now be attempted in order to show how the question of a suitable monetary standard had been shelved from stage to stage. At the beginning of the last century no uniform measure of value existed in British India. Some parts of India like Madras had a gold standard and a gold currency while in others there was a silver standard with gold coins in circulation. But by 1835 the silver rupee was finally established as the standard coin of the whole of British India; and though gold ceased to be legal tender, the coinage of gold mohurs was authorised by the Act of 1835 and gold mohurs were accepted by Treasuries in payment of dues to the Government. With the extensive discoveries of gold, gold came to be overvalued and the Government declined by notification of January 1, 1853 to receive gold in payment of its dues. With the first shock to a stable link between gold and silver the idea of adopting a gold currency with a circulation of gold coin began to be entertained. It was proposed that the British sovereign and half-sovereign should be adopted.

"The Imperial Government, while unwilling to make the sovereign a legal tender, saw 'no objection to reverting to a state of matters which prevailed in India for many years, namely, that gold coin should be received into the public treasuries at a rate to be fixed by Government and publicly announced by Proclamation.' It was considered that this experimental measure 'will, as far as it goes, facilitate the use of the sovereign and half-sovereign in all parts of India; it will pave the way for the use of a gold coinage in whatever shape it may ultimately be found advisable to introduce it; and at the same time, it establishes a preference in favour of the sovereign.' Accordingly, on 23rd November, 1864, a Notification was issued that sovereigns and half-sovereigns should, until further notice, be received as equivalent to 10 rupees and 5 rupees respectively, in payment of sums due to Government."

"On 28th October, 1868, the Government of India raised the rate for the receipt of sovereigns and half-sovereigns at the public treasuries from Rs. 10 and Rs. 5 to Rs. 10½ and Rs. 5½, respectively."

CIRCUMSTANCES LEADING TO THE CLOSING OF THE
MINT IN 1893

In the years that followed, opinion in India and Britain inclined more definitely to the adoption of a gold standard. But differences of opinion as to the exact method of the transition stage stood in the way of any change being effected. The fall in the gold price of silver, which persisted from 1878 to 1892, gave the problem of India's currency an altogether new setting. For its most direct, and, in a view, most serious effect was to increase the weight of the Government's foreign obligations which had to be paid in sterling. Since these foreign obligations, better known as Home Charges, formed a considerably large part of the Government's total expenditure, the uncertainty of exchange reduced the budget to a useless and random guess work; and even the heaviest increases in taxation possible at the time did not suffice to fill the gap. Some time was lost in the expectation of an international agreement to stabilise the gold value of silver; and as it became evident that no such agreement was possible, the British Government, acting on the advice of the Herschell Committee, closed the Indian mints to the unrestricted coinage of silver. The Committee had also insisted that "the closing of the mints against the free coinage of silver should be accompanied by an announcement that, though closed to the public, they will be used by Government for the coinage of rupees in exchange for gold at a ratio to be then fixed, say, 1s. 4d. per rupee; and that at the Government treasuries gold will be received in satisfaction of public dues at the same ratio."

The Government, therefore, made arrangements by Notification of June 26, 1893, "(1) for the receipt of gold at the Indian Mints in exchange for rupees at a rate of 16d. per rupee, (2) for the receipt of sovereigns and half-sovereigns in payment of sums due to Government at the rate of Rs. 15 for a sovereign, and (3) for the issue of Currency Notes to the Comptroller-General in exchange either for British gold at the above rates or for gold bullion at a corresponding rate."

CONSEQUENCES OF THE CLOSURE OF MINT

It will be seen from this that, though 1893 is usually regarded as the beginning of the history of Indian currency, it was in that year that the foundation of the system as we have had it ever since was truly laid. For the earlier proposals for the adoption of the gold standard were for all practical purposes put aside. The closing of the mints to the free coinage of silver not only made the rupee a token coin but gave it virtually exclusive status as legal tender. Gold stood aloof from the currency system with a loose relation to the national currency. And the volume of internal currency circulation was left as a matter of administrative discretion.

ADMINISTRATIVE DISCRETION—THE PRIMARY FACTOR IN DETERMINING THE VOLUME OF INTERNAL CIRCULATION SINCE 1893

The first instance of discretionary addition to currency circulation in India was in January 1898 when "in order to afford a means of relief to the severe stringency" then prevailing in the Indian money market, the Government of India announced, "that notes would be issued, in exchange for gold held by the Secretary of State for India, at the rate of one Government rupee for 7.53344 grains of fine gold, with the addition of such further quantity of fine gold as the Secretary of State should from time to time determine to be 'sufficient to cover all costs and charges incidental to the transmission of gold to India.'" The provision of rupee currency was linked to India's favourable balances in London when "under this Notification, the Secretary of State in Council gave notice of his readiness 'to sell, until further notice, telegraphic transfers on Calcutta, Madras and Bombay, at a rate not exceeding 1s. 4 $\frac{5}{8}$ d. for the rupee.'" This Act was extended for a further period of two years by the amending Act, No. VIII of 1898." Thus within a few years of the abandonment of silver, all the familiar features of the Indian currency system had already emerged to view, an ultimate, distant link with gold, discretionary additions to currency circulation, sale of Bills in London on India by the Secretary of State. The position as it stood at the time of the Fowler Committee, which was the

next Committee of enquiry into Indian currency and exchange, may be stated in the Committee's words:

"At the present time, gold is not a legal tender in India, though the Government will receive it in the payment of public dues; that the rupee remains by law the only coin in which other than small payments can be made; that there is no legal relation between rupees and gold; but that the Indian Government has declared (until further notice) a rate at which rupees can be purchased for gold coin or bullion, such rate serving to determine the maximum limit to which the sterling exchange can rise under present arrangements."

If a system of such indeterminate character worked well in practice it must be attributed in the main to the intrinsic strength of India's national economy, as seen in the presence, as a rule, of large favourable balance of trade. Contrary to the expectations entertained in 1893 gold was tendered to the Government and automatically, therefore, existing currency arrangements sufficed not only to maintain without monetary stringency—a steady gold standard in 1898-99 but also to initiate a gold reserve in India, to serve as a bulwark for the maintenance of the gold standard in future years.

DIVERGENCE BETWEEN FOWLER COMMITTEE'S RECOMMENDATIONS AND SUBSEQUENT DEVELOPMENTS

The Fowler Committee was appointed, so to say, to tie up the loose ends of this scheme of affairs, to decide the question which had not ceased to be, of a return to a silver standard, the adoption of a gold standard and the link between the rupee and the pound. One would think that with the record of the five or six years since the closing of the mints to silver India was set on the road to the adoption of a full-fledged gold standard. But that was not to be. It might be thought that it is of historical, more than of immediate practical, importance to decide how so natural a development failed to take place. The fact remains, in the first place that, though the Fowler Committee declared themselves unequivocally 'in favour of making the British Sovereign a legal tender and a current coin

in India' and turned down the schemes of Mr. Lindsay and others for a gold exchange standard, the Indian currency system was developed on the lines of an exchange standard with all the scope that it allows for the errors of judgment which an irresponsible Government is capable of.

INDIAN PUBLIC NOT ABOVE REPROACH

For this unfortunate *denouement*, the Indian public mind must no doubt, take its share of the blame. While the main reason for India's failure to secure a gold standard is to be found in the fact that a managed currency system suited the interests of Britain admirably, the Indian public and Indian conditions also gave them good pretext to withhold gold from circulation. For, on the recommendations of the Committee of 1898 the Government of India did make an active effort to induce the people of India to use sovereigns as a medium of circulation. The Currency offices were instructed to offer sovereigns to presenters of notes, while giving rupees to any one who objects to receive sovereigns, and at the same time the Post Offices and other institutions under Government control were utilised to press sovereigns on the public. The results were unsatisfactory. Many of the gold coins soon made their way back into Government's hands, and the Government found themselves unable to cash currency notes in rupees not only at the Cawnpore and other treasuries in the North-West Provinces (where though not legally bound to do so, they had been in the habit of encashing notes) but on the 11th April 1900 at the Head Office in Calcutta itself; notes became subject to a discount of as much as 7/16th per cent in the paper currency. Meanwhile, sovereigns also went to a discount of as much as 4 annas in many places. Special demand for rupees, owing to famine conditions, and the inadequacy of the supplies of the favourite circulating medium combined to aggravate the general monetary stringency.

THE ESTABLISHMENT OF THE GOLD STANDARD RESERVE IN LONDON AND THE SALE OF COUNCIL BILLS

The failure of this attempt opened the eyes of the British Government to the possibilities of keeping the currency sys-

tem of one of the great trading nations of the world on a frankly artificial basis. The more complicated aspects of the currency system of a country which had a large annual trade balance but had an internal currency of token silver coin and notes began to develop fast. The profits on the coinage of rupees were, according to the Committee of 1898, to be held in a separate reserve and not taken to revenue account. Its function obviously was to help in the maintenance of the external value of the rupee at all times and to secure the convertibility of the rupee into gold, should such a measure ever commend itself to the authorities or become feasible in the conditions of this country. The fund itself assumed big proportions when the coinage of rupees was resumed on a large scale after the failure of the attempt to put gold into circulation. The emphasis having been shifted from convertibility of rupees into gold at home to availability of gold for external payments, London seemed to be the obvious choice for locating the funds. After a preliminary stage of apparently wasteful movement of funds and bullion from London to India and back, the authorities naturally hit on the idea of letting these funds accrue in London by the simple device of the Secretary of State offering to sell Council Bills without limit at the price of 1s. 4½d. This was an extension of the practice introduced in 1898 of selling Council Drafts for gold in London and issuing notes against such gold in India. When the demand for these Drafts is very strong and the Treasury balances of the Government of India are insufficient to meet them, they are met by the withdrawal of rupees from the Paper Currency Reserve in India against a corresponding deposit of gold in the Currency Chest in London and if necessary by the withdrawal of rupees from the Indian Branch of the Gold Standard Reserve. The Government meanwhile purchase silver, if necessary in London out of the proceeds of the Council Drafts sold there and ship it to India to be coined into rupees.

The price of 1s. 4½d. for Council Bills approximates to the normal gold export point from London to India, but was not at all times prohibitive of such export of sovereigns.

The Gold Standard Reserve which was built up out of the profits of coinage of token Silver Rupee were increasing at

such a rate that the Secretary of State for India decided at one stage that one half of the profits on rupee coinage should be used for capital expenditure on railways and a sum of 1.2 million was actually provided for the purpose.

THE CRISIS OF 1907-8 AND THE SALE OF REVERSE COUNCILS

The check to this optimism, however, came soon after in 1907-08 when at the beginning of the winter of that year, the Indian exchange became very weak as a result of a partial failure of the monsoon and the monetary stringency which accompanied the American financial crisis. The crisis in exchange was badly handled by the Government which, while giving gold for internal purposes refused to give gold for export in larger quantity than £ 10,000 to any one individual in a day. The mistake was rectified; and more than £ 8 million had to be withdrawn from the Gold Standard Reserve. The Government saw the other side of the working of a managed currency, that is, the reverse of the process of selling Council Bills.

CHAMBERLAIN COMMISSION'S UNQUALIFIED APPROVAL

The crisis of 1907 proved shortlived and the position improved so rapidly thereafter that the Chamberlain Commission observed: Since 1907-08 India has enjoyed a period of exceptional prosperity, and during this period the demand for remittances from London to India has been so strong as not only to call for the re-issue of the large stocks of rupees accumulated in India during the crisis of 1907-08 and thus incidentally to restore the Gold Standard Reserve in London to its former amount, but also to necessitate large coinages of fresh rupees in 1912-13 and 1913-14 the profit on which has gone to increase the Reserve far beyond the maximum point reached before 1907-08.

Thus in the decade that followed the report of the Committee of 1898 the measures taken to maintain the exchange value of the rupee were less in pursuance of the Committee's recommendations than supplementary to them. And the Chamberlain Commission's description of these measures

shows the principal divergences from the intentions of the previous Committee.

The investment of the Gold Standard Reserve in securities in London, the dropping of the scheme for a gold mint in India, the practice of selling Council Drafts at something below gold point against the currency reserve, the establishment of the silver branch of the Gold Standard Reserve, the diversion in 1907 of money from that Reserve for capital expenditure and its use in 1908 for meeting drafts sold by Government in India on London to private traders, are all examples of divergences from the scheme adumbrated by the Committee. Thus, in spite of the fact that the Government adopted and intended to carry out the recommendations of the Committee of 1898 the Indian currency system to-day differs considerably from that contemplated by the Committee, whilst the mechanism for maintaining exchange has some important features in common with the suggestions made to the Committee by Mr. A. M. Lindsay. The system actually in operation has accordingly never been deliberately adopted as a consistent whole, nor do the authorities themselves appear always to have had a clear idea of the final object to be attained. To a great extent this system is the result of a series of experiments.

It is this "result of a series of experiments" which obtained the eulogy and the blessings of the Chamberlain Commission, which submitted its report early in the year 1914. Just as the Fowler Committee approved of and confirmed the abandonment of the silver standard, the Chamberlain Commission approved of and confirmed the abandonment of the gold standard. It gave its whole-hearted support to all the deviations which the officials in India and Britain had effected from the recommendations which the Fowler Committee had made for the establishment of a gold standard with gold coins in circulation. It found with obvious satisfaction that though the Fowler Committee recommended gold currency in active circulation as an essential contribution for the maintenance of the gold standard in India, "the history of the last 15 years shows that the gold standard has been firmly secured without this condition." It went farther than that and observed that "the people of India neither

desire nor need any considerable amount of gold for circulation as currency"; that "the currency most generally suitable for the internal needs of India consists of rupees and notes," and therefore "it would not be to India's advantage to encourage an increased use of gold in the internal circulation." The proposal of a mint for the coinage of gold was dismissed as "not needed."

The Chamberlain Commission, therefore, gave its support to the amorphous "result of a series of experiments" by declaring that "the establishment of the exchange value of the rupee has been and is of the first importance to India," and that "the essential point is that the internal currency should be supported for exchange purposes by a thoroughly adequate reserve of gold and sterling." To this end, they declared that no limit should be fixed to the amount to which the Gold Standard Reserve should be accumulated, recommended the abolition of the Indian Branch of the Reserve and went in some detail into the routine of the administrative measures necessitated by this system of currency and exchange. Perhaps, the most significant part of the report was the Commission's record of their "high opinion of the way in which the permanent staff, both in India and in London, have performed the complicated and difficult financial duties placed upon them."

INDIAN CURRENCY DURING AND AFTER THE WAR OF 1914-18

This resume of the historical developments in regard to the standard should serve to show that in a brief period of less than two decades the Government succeeded in inventing an exchange standard which, administratively speaking, obviated the need for a gold currency and gave immense scope for the accumulation and manipulation of large amounts in the various reserves. The opportunity for utilising this mechanism was not long in coming. The Chamberlain Commission submitted its report early in the first year of the last war and, broadly speaking, the war brought to India a period of great economic prosperity because India was able to supply material which was urgently required for the prosecution of the war. India had thus an increasingly heavy

balance of payments. The transfer of those war profits from London, where they were realised, to India where they were due naturally raised special problems, when the normal ways of effecting that transfer were either rejected or were not open. The basis of the internal currency was token silver coin; but the price of silver soared so high that the bullion value of the rupee exceeded its token value. This situation opened up for the Government the prospect both of large scale purchases of silver at high prices and for frequent and steep increases in the external value of the rupee. The rate of exchange was raised by stages from the old sacrosanct level of 1s. 4d. to as high as 2s. 4d. on the ground of the increase in the bullion value of the rupee. The artificial character of the rise in the price of silver, which the ban on the export of silver from India was by itself sufficient to testify to, was wholly ignored. And since the demand for rupees was insistent, silver was brought from America under the special provisions of the Pittman Act at a price of 80d. per ounce. This silver, India sold in the years of the depression at a price in the neighbourhood of 20d.

ERRATIC MOVEMENT IN THE EXCHANGE RATE AFTER THE LAST WAR

But the worst effects of the managed currency occurred, however, after the end of the war. The consequences of the steep rise in the rupee-sterling rate began to be felt soon after peace was signed. All the accumulated reserves of the war period were dissipated in the effort to bolster up a high exchange. It should suffice here to mention the net results of these attempts. India's sterling assets in the paper currency reserves which rose from Rs. 4 crores at the beginning of the war to Rs. 51.48 crores by the middle of 1917 and Rs. 82.50 crores by February 1920 fell before the end of the year to Rs. 8.35 crores and Rs. 5.85 crores by December 1921.

BABINGTON-SMITH COMMITTEE'S HISTORIC RECOMMENDATION OF GOLD RATE AND GOVERNMENT'S FAILURE IN THE ENDEAVOUR

It was in the beginning of February 1920 that the demand for remittances to London assumed big proportions owing to

an enormous increase in imports and a fall in exports. The Babington-Smith Committee had reported in favour of a 2s. exchange rate and for the maintenance of the gold exchange standard in the face of all that happened towards the close of the war. One would have thought that considering the difficulties experienced in regard to the maintenance of the internal and external value of the silver token rupee, some attempts would have been made to explore the means by which a more satisfactory currency system could be established in India. But the Babington-Smith Committee's terms of reference were to make recommendations to ensure a stable gold exchange standard. Only Mr. D. M. Dalal expressed in a dissenting minute his opinion that "the gold exchange standard as applied to India is entirely discredited as a currency system intended to meet Indian conditions" and declined to make any recommendations for its continuance. The majority, on the other hand, found that "the rise in exchange in so far as it checks and mitigates the rise in Indian prices had been to the advantage of the country as a whole and that Indian trade was not likely to suffer any permanent injury from the fixing of exchange at a high level." On the strength of this report, the Government of India continued to support the 2s. rate whose consequences in the years following are some of the bitterest memories of British rule in India.

HILTON-YOUNG COMMISSION AND AFTER

The last of the Indian currency enquiries thus took place in the conditions in which India's foreign reserves had been dissipated in a palpably futile attempt to support an unconscionably high level of exchange, and the rupee sterling ratio itself was in a highly unsettled state. The Hilton-Young Currency Commission thus felt called upon to go with greater thoroughness into all the problems connected with Indian currency and exchange. It posed its main problem, as firstly to determine the proper level at which the external value of the rupee could be stabilised, secondly to suggest such changes in the system as would remove the extreme unpopularity of the gold exchange standard and thirdly to formulate for India a scheme for a Central Banking Institution.

The main recommendation of the Commission was, how-

ever, for the maintenance of the exchange rate at 1s. 6d. to the rupee. As need hardly be said, the Indian Member, Sir Purshotamdas Thakurdas was the author of a minute of dissent in which he endeavoured to show that at 1s. 6d. the rupee would be over-valued and that the country would suffer so long as the rate was on the Statute Book from the effects of high exchange. Though it is usual in British financial circles to describe it as the ratio controversy the effort that the Government had put forth at the expense of trade and industry of the country to support this ratio should be sufficient evidence of the fact of over-valuation. One has only to remember that till Britain's abandonment of the gold standard automatically brought down the external value of the rupee in terms of gold, India had to suffer a consistently deflationary policy brought about by contractions of currency and by the removal of large amounts of money from the money market by heavy sales of treasury bills amounting at one time to as much as 85 crores against the normal of about Rs. 25 crores.

It will be seen from this cursory account of the rupee exchange that India suffered from the British administration of our gold exchange standard not only through the dissipation of the foreign reserves built out of the profits of rupee coinage but also through the serious setback caused to Indian trade and commerce by the deflationary policy necessitated by the requirements of high exchange. The industrial boom, which India experienced in the years immediately following the last war, was brought to an unnatural end by the uncertainty of exchange and the deflationary policy of the authorities. In the years before the depression the monetary screw was kept so tight that the natural development of the country's banking and credit system was rendered impossible.

We may now turn to a consideration of the third test—the growth of a system of internal currency and credit. It has been mentioned already that the gold exchange standard left the question of additions to the internal rupee circulation entirely to the discretion of the authorities and that, as a result, the system was lacking in the capacity for automatic expansion and contraction according to the needs of prevalent circumstances. When one thinks of it, it is indeed impossible that a national banking system could grow up in conditions

in which the public at large is 'unable to place confidence in the monetary standard.

Sir James Begbie, who was a member of the Chamberlain Commission, pointed out that the hoarding habit, which was held by the majority to be sanctioned by the experience of centuries in India and to militate against the introduction of a gold currency with gold coins in circulation "was to a large extent the outcome of the policy which brought into existence the extensive token currency." This view that the system of internal banking and credit can be built up only with sound monetary standard on the one hand and an efficient central banking institution on the other was somewhat slow to gain its hold over the Government in this country, and the Hilton-Young Commission, while it brought a central banking institution nearer could do little by way of giving India a sound monetary standard.

The three principal recommendations of the Hilton Young Commission, it may be recalled, are the maintenance of the rupee rate at eighteen pence, the adoption of what was called the gold bullion standard and the establishment of a central banking institution. Of these three, the rate of eighteen pence gold came to an end with Britain's abandonment of the gold standard and the rupee was cured of its overvaluation by the depreciation of sterling. The Reserve Bank of India was established in 1934 after a great deal of controversy about the merits of a State Bank and a Bank with private capital. And the gold bullion standard was again whittled down to the old gold exchange standard by giving the Government the right to give sterling instead of gold in return for rupees.

THE PRESENT WAR AND INDIAN CURRENCY.

The only notable improvements in the Indian currency during the years preceding the present war were, the abandonment of the deflationary policy after the abandonment of gold and the establishment of the Reserve Bank of India. Otherwise, the exchange standard, which had done great disservice to India during the last war, remained intact on the outbreak of this. The existence of a Reserve Bank as a separate institution from the Finance Department has not made,

and cannot indeed be expected to make, any difference to the currency policy of the war period being out of accord with public opinion and national interest. There has thus been up to the moment of writing a striking similarity between developments during the last war and the developments during this. To all appearances, this war, too, has given India great prosperity on account of her ability to supply materials which is needed urgently and on a large scale for the prosecution of the war. - The balance of payments is heavily in favour of India. But these payments have been made so far only in the shape of increasing sterling securities in the currency reserves abroad and large scale additions to the note circulation at home. The magnitude of these changes may be appreciated from the fact that the note circulation in India has increased from the level of about Rs. 180 crores before the outbreak of war to over Rs. 900 crores by the middle of May 1944. Sterling securities in the currency reserve which used to be in pre-war times at about Rs. 70 crores now stand at over Rs. 800 crores. And this increase is in spite of the fact that nearly Rs. 400 crores worth of sterling securities have been utilised for the repayment of the foreign indebtedness of the Government of India.

The main points of difference between the last and the present war in the sphere of Indian currency are, firstly the vastly bigger scale of additions to sterling assets and note circulation, secondly the utilisation of sterling for the repayment of our foreign loans, thirdly, the promise of the Government of India to accumulate a certain amount of dollar balances to the credit of India and fourthly, a keener awareness both in India and abroad of the existence of these large assets and their importance in the national and international financial problems of the future.

THE FUTURE OF INDIAN CURRENCY

Overlooking what remains of the war period, and such uncertainties as it may contain, we may now look into the problems of Indian currency as we may be called upon to tackle them in the post-war period. Here again, the three tests of a sound monetary standard, a scientific link with foreign currencies and a healthy growth of a system of internal

credit and currency circulation will be found to be the best. All the established ideas in regard to the first two have during recent times become more or less wholly obsolete. Problems of the monetary standard as they were framed and discussed a decade or two ago have now a strangely anachronistic ring about them. There is hardly a country in the world which thinks of a stable and inviolate link between its national currency and gold. Gold is a relic of a bygone age of barbarism; its maintenance in circulation in the form of coin is hardly considered. A stable link with foreign currencies has suffered the same fate as gold, being bound up with it. And internal credit is dependent so largely on the broad policies pursued by the national central banking institution that it can be discussed not in terms of the volume of savings and deposits but in terms of price levels, national and international, and of the structure of costs and prices.

All this is true of India as of the progressive nations of the West, though to a slightly less extent. India has been educated, perhaps over-educated, to the use of notes, though the use of cheques in ordinary daily life is not as widespread as one would like it to be. The use of tokens has spread to the point of using rupees with a ludicrously low content of silver. Nevertheless, the problem of educating the people as a whole out of the habit of hoarding still remains to be tackled. The total value of the hoards in India is estimated at nearly Rs. 1,000 crores. The relation between a sound monetary standard and the curing of this hoarding habit, which Sir James Begbie emphasised, may not be altogether ignored, especially if some part of the capital needed for our future development is to come from these hoards. In view of the strong position which India will occupy in international trade and finance, it is a question for consideration whether a sound and simple gold standard will not have its uses in attracting money from the hoards.

MEASURES TO CHECK THE PRESENT INFLATION

Otherwise, the problem of the standard resolves itself into the regulation of the internal circulation and the maintenance of the external value of the rupee. As regards the internal circulation, the riotous inflation that has happened

during the present war period and the giddy price levels now reached will have to be adjusted to post-war conditions and requirements. It is well to remember in this context that, in so far as sterling securities are the basis of the vast currency expansion, post-war currency contraction will lead to a diminution of our foreign assets. The link between the increase in sterling securities and the increase in the note circulation should not, however, be exaggerated. These two twin developments are the result of the failure of the Government of India to insist that the war expenditure incurred by the Allied Governments in India should be paid for in rupees, and that the finding of rupee finance for that purpose is a problem which the foreign Governments should solve for themselves. As it is, the Allied Governments pay for this expenditure in sterling in London, and the Government of India makes the payments to the private parties with the aid of a note issue expanded on the strength of the rising foreign assets. By this means the problem of transferring India's war balances to India is shelved, not solved. The first step in solving the problem is what has been mentioned already, the repayment of the Government of India's foreign indebtedness.

THE POLICY OF GOLD SALES

The next step is the sales of gold by the Reserve Bank on behalf of the Allied Governments. These gold sales which started early in 1944 were thought of by the Allied Governments with a view to check the inflationary tendencies in countries like India and Egypt. Such a check was thought to be necessary, firstly, as an aid to these countries in combating the effects of inflation and, secondly, as a means of preventing further rise in prices to the detriment of the Allied Nations in the countries in which large scale war expenditure has still to be incurred. But so far as India is concerned, these gold sales have acted as a further irritant to public opinion. For one thing, the price at which gold is now sold to the Indian Public is in the neighbourhood of Rs. 75 per tola while India has in the past parted with vast quantities of gold at less than half this price. Though the difference in the purchasing power of the rupee in these different periods is a matter of great importance, the policy of the Government in regard to

gold strikes the public as one of total indifference to national interest and public sentiment. To the individual, differences in price levels must seem abstruse and irrelevant, while from the national view-point, the failure of the Government to conserve the gold resources of the country either at the time of dishoarding by the people or when foreign governments offer it for sale is a patent disservice to the future of India's finance. Quite apart from this aspect of India's sales and purchases of gold, the present sales effected by the Allied Governments seem but a drop in the ocean of inflation. They are no contribution either to our solution of the problem of inflation or to our problem of increasing and mobilising our gold resources.

THE QUESTION OF LIQUIDATION OF FOREIGN INVESTMENTS IN INDIA

The third likely means of financing Allied war expenditure in India, one which is in accord with the usual means of settlement of adverse balances of payments, is the transfer of British investments in India from foreign to Indian hands. Once the programme of repayment of sterling loans of the Government of India was completed, it was naturally expected that the next step would be the sale of British investments. This, however, has not come about. On the other hand, at the stage at which it was thought of, certain sections of the British Press started to suggest that India's sterling assets were the result of unwise generosity on the part of the British Government in the allocation of military expenditure incurred in India between themselves and the Government of India. The merits of this latter question are not, however, relevant here, though it should perhaps be stated as an aid to understanding the whole picture, that India has borne her defence expenditure to the limit of her capacity and that India's sterling assets have been earned at the price of immense suffering of all classes of the population, the famine in Bengal being only an acute instance of what has been in a lesser degree true of economic conditions all over the country for nearly two years now. The attack, in the face of these circumstances, on India's sterling assets was probably intended to raise a degree of ethical doubt in the Indian mind about the propriety

of trying to take the fullest advantage of these foreign assets. Its practical implications are, firstly, the possibility of a revision of the system of allocating military expenditure, such as would not only prevent further additions to our sterling assets but may conceivably cause cuts therein; secondly, the effective discouragement of the hope of transfer of British investments in India to Indians; and thirdly, preparing the ground for proposals of blocking sterling or of protracted repayments. Indeed, the proposal to constitute a special industrial Reconstruction Fund out of the sterling assets was made by the Finance Member of the Government of India in March 1943, soon after the British Press adopted this line of comment. Though this proposal is now moribund due to protests in India and misgivings in the U. S. A. about effective Indian demand in the post-war period for other than British goods, the sale of British investments in India is no longer regarded as a possibility. However, the inflation which results from the avoidance of this and similar measures increases the pressure for the sale of British investments in terms of rupees. For, inflation not only increases the value of these investments in terms of rupees, but also drives Indian capitalists more powerfully to seek a hedge against inflation without bargaining too hard for the price to be paid for British concerns in India.

The value of this transfer of British investments to the solution of the problem of inflation is, however, extremely limited. British investments in India may be estimated for the purpose at about Rs. 400 crores against Rs. 1,000 crores which India's sterling assets may be expected to amount by the end of the war. When, therefore, sterling securities far outgrew the value of British investments in India, Indian opinion, too, ceased to attach much importance to it.

The position, then, may be said to be that India's sterling securities have to be thought of, in the post-war period, in relation to our needs of foreign currency for the purposes of accelerated economic development and in relation to the schemes for the regulation of post-war international finance. There is no ground for the fear that any large portion of these sterling assets will have to be earmarked for meeting possible adverse balances of trade in the post-war period. For one

thing, an adverse balance of trade is exceptional in the whole history of India. The fact, that a large part of her export trade consists of monopolies like jute, shellac and manganese and her competitive capacity in other goods is not too low, should suffice to cure us of all fears of heavy adverse trade balances cutting into our sterling reserves. For another, conditions after this war will in many respects be radically different from condition after the last war. The scarcity of goods of various kinds over large areas of the world may preclude the flow of imports into this country on any large scale. Indian industrial development, too, has been so rapid and so diversified during the last decade that our dependence on imports for ordinary consumer's goods has been reduced quite remarkably. Only capital goods will India need on a large scale, particularly because the national mind is set on working a scheme of planned economic development, for which what is known as the Bombay Plan provides illuminating outlines. But the normal capital requirements can reasonably be expected to be financed in part by the normal favourable balance of payments which may be increased alike by an increase in normal exports and a decline in normal imports. Our sterling assets may, therefore, stand quite apart from our normal trade and finance, to be utilised according to a predetermined programme for the import of capital goods and for financing special schemes of industrial and economic development.

The problem of internal currency circulation and domestic price levels, too, can be detached from the problem of foreign assets. It is necessary to emphasise in this context that the note issue in India has other support than the volume of sterling securities which now figure so largely in the returns of the Reserve Bank. The gold which is now shown in the weekly statements of the Reserve Bank at Rs. 44 crores is valued at the pre-1931 price. The failure to revalue the gold leaves out an asset of great importance. Another feature of the currency returns is the almost total absence of self-liquidating commercial bills as a support to the note issue. And in the last resort, the country has a large hidden reserve in its hoard of precious metals which can be coaxed into the coffers of the Reserve Bank when a truly National Government will evoke the enthusiasm of the people for a programme of

planned economic development.

While, thus, India will not lack the backing, apart from our foreign assets, necessary for any expansion of currency that she may reasonably want to effect in the future, the need in the immediate post-war years would be for a contraction of currency with a view to bring down the volume of circulation and the price level. On this question, it is certainly premature to consider details. Much will depend on the nature of the measures that will be adopted in what remains of the war period in order to combat inflation. The most significant part of the measures now adopted, apart from direct control of prices, is a recent declaration of the Government in regard to the control of capital issues. The aim now is to encourage industrialists to formulate in detail their plans for new enterprises in the post-war period and to secure in the present favourable conditions the requisite capital, provided of course, the schemes are on the whole consistent with present ideas of post-war conditions, needs and policies. Of the capital so raised the major portion is to be kept invested in Government Securities until the time when conditions are favourable to the actual execution of these projects, and then that capital will be made available to the promoters. It is reasonable to suppose that the business community will be ready to act on this suggestion of the Government, since in the absence of opportunities for actual execution of projects, non-availability of the capital should cause no difficulty provided, of course, control by Government is exercised in the interests of India. If new issues should show in the coming months a vast expansion, the post-war period will see this frozen capital thaw and flow into active circulation; and the inflationary effects of this renewed flow of active capital will have to be watched with great care.

MITIGATION OF POST-WAR DEFLATION

It may be said both on this ground and on others which it is not possible to go into in this context that, without a considerable expansion in the volume of goods and services, the whole problem of adjusting war-time inflation to peace-time conditions will be extremely difficult of solution. From whatever point of view one may consider it, it will be seen

that currency circulation, as it is now and as it may be for some years to come, must be supported by a genuine expansion of productive activity at home. Increased imports will afford no substantial relief to this problem; in fact, what is needed is not an avenue of expenditure. The volume of production has to grow to the new currency and thus stabilise at a higher level than before the war the normal volume of the note circulation. This view derives strength from a broad survey of the conditions in other countries of the world. The pre-war note circulation in India was low, considering alike the total population and the per capita income. A part of the solution of the problem of war-time inflation must be found therefore, even while the war is on, in the increase of production of ordinary consumer's goods.

The increase in the volume of goods and the rise to a new level of the note issue would alike leave scope for the reduction of the note circulation. Such reduction may well be effected by the establishment of a special development fund, comprising sterling and dollar securities to the tune of Rs. 600 crores. The pace and manner, at which this Fund is to be drawn on for purposes of our economic development may well form the subject of special understanding with Great Britain and the U. S. A.; and such agreement will naturally form part of the arrangements for the liquidation of war-time balances in the wide sphere of post-war international finance as a whole. The removal of an amount of Rs. 600 crores of foreign securities from the currency reserves will leave the field clear for a contraction of currency of about the same amount and there can be no doubt that this figure will form the outer limit of the reduction needed in the note issue. As explained at an earlier stage, the removal of these securities need not set a corresponding limit to the note issue since expansion, if and when needed, can be effected by other means like, for instance, revaluation of gold.

For, it is not to be supposed that, if inflation is an evil, deflation is necessarily good. The fact, however, is that if inflation is Satan, deflation is Beelzebub. The evil effects of deflation on the last post-war boom were referred to earlier, and a repetition of that blunder has clearly to be avoided. The process of contraction of currency has, therefore, to be

clearly watched with the readiness always to deny deflation the benefit of doubt. All that can be said at present is that the present level of prices and currency circulation should be adjusted well ahead of the time when the new projects of the post-war period will be brought into execution.

THE DIFFICULTY OF DETERMINING THE EXTERNAL VALUE OF THE RUPEE

As for the external value of the rupee, the determination of its exact level will always be a difficult and complicated problem. What the relative price levels will be, it will be futile to conjecture. It should suffice for us that India's normal balance of trade, taken together with our foreign assets, will suffice to spare us any grave problem in the sphere of exchange. If our past experience and the experience of other countries show us anything, it is that impatience in fixing a rigid rate and frantic devotion to its maintenance will land both India and her foreign customers in serious difficulties. It is encouraging from this point of view that in the scheme for the International Monetary Fund prepared jointly by the British and American experts there is provision for changes in the exchange rates. India may well have need to avail of these provisions, whether she participates in the scheme or chooses to keep out of it.

INDIA AND THE INTERNATIONAL CURRENCY OF PROPOSALS

This survey of the history and problems of Indian currency is best concluded with a reference to India's relations with international finance. From the earliest times known to history, India has been a great trading nation. She was a supplier of rare goods and luxuries in the past and developed during the period of the industrial revolution into a supplier of raw materials for industry in the west. Trade in these as a rule brought her a large favourable balance of trade which she realised in the form of import of gold and silver. And she has been known abroad as a grower of raw materials and as a sink for the precious metals. But India has far outgrown the stage when such descriptions could give a correct picture of her position in world trade and finance. Even before this war broke out, she took the tenth place among the

industrial nations of the world; and the war has quickened the industrial and economic consciousness of the country. It has relieved her of the huge burden of external debts and has given her, as did the last war to the U. S. A., the status of a creditor nation.

The best brains in the country are now applying themselves to the formulation of an economic plan which will secure the orderly development of the national economy so as to ensure the minimum requirements of decent life for the teeming millions of this country. Preliminary investigations tend to show that no serious difficulties need be apprehended in working out such a plan to a successful end.

• Our problems of currency and exchange have, therefore, to be thought out in relation to the requirements of a future which will be dominated by such a plan. And it is certainly heartening to find that the conditions of post-war finance will be such as to afford all the help that the directors of planned economy will need to ask for. The three specific requirements of the plan in the sphere of currency are a simple and intelligible standard of value, a system of internal credit which can ensure finance acting as the handmaid of industry and thirdly such relations with other countries of the world as will redound to the mutual advantage of India and the rest of the world. So far as the ordinary standard is concerned, the position of gold in national and international finance rules out all other alternatives; and the choice is to be made from among the many variants of the gold standard which have developed in recent times. And here it may be said that what India has suffered from the gold exchange standard in the past is to be attributed, not to the system, but to the spirit in which it was administered. There can be no doubt that with the establishment of a National Government and a free constitution, India will be able to work the gold exchange standard to her own national advantage. The question of making the system intelligible to the ordinary man will lose much of its importance, when the devotion of the government to the national interest will no longer be open to doubt. Some measures calculated to demonstrate the gold value of the national currency and thus to draw gold from the hoards may be necessary; and they will have to be devised in reference to the conditions of the

future. The Reserve Bank, which will be a truly national institution, should be able to formulate such measures and work them successfully. By these means the Reserve Bank will be able in the first instance to make the organised banking system of the country cover,—as it does not at present,—the whole field of provision of credit for productive work and, secondly, to build up gold reserves which will be commensurate with the bigger scale of the national income and the increased importance of the country in international finance. In such conditions, credit and currency and prices will be more readily amenable to control by the Central Bank than they have been till now; and the complicated problem of adjusting war-time inflation and regulating circulation and price-levels to the requirements of a programme of expanding production will be solved by the Reserve Bank with the help of an alert and informed public opinion.

As for the relations with the outside world, they extend in modern conditions far beyond the regulation of the external value of the national currency. In fact, exchange rates and their regulation form but a part of the sphere which enlightened international opinion seeks to entrust to an international financial organisation. The scope of activities of such a body varies with the practical difficulties of securing international agreement for a specific scheme. The International Monetary Fund has a narrower orbit than what was contemplated by the U. S. experts for the International Stabilisation Fund. So far as India is concerned, her main requirements in regard to any such scheme are: (1) reasonable liquidity (and convertibility) of her war-time balances, (2) an independent place and voice for her representatives in the governance of the international financial organisation, (3) recognition of the special needs and requirements of the undeveloped countries of the world like India and (4) freedom to serve the national interest without interference either from the international financial organisation or from the British Commonwealth of which she is now a dependent member.

Most of these points are closely inter-related. India's political relations with Britain impinge on many aspects of her relations with the International Monetary Fund. Because of these relations, she may be denied the free use of her foreign

balances, she may be forced to be a member of the sterling area, her representatives may be but a part of the representatives of the British Empire in the management of the fund, the external value of her currency may be expressible only as a rupee sterling rate which she cannot change at will and the Fund may treat her as a backward subject country fit only to grow raw materials for industry in the West. All these have to be changed if India is to join the Fund of her own accord and be an enthusiastic and useful member of it. She must have an independent place in the Fund. Her membership of the sterling area must be the free choice of a national government. But whether or not she is to be in the sterling area, she must have freedom to change the exchange rates according to her needs and conditions. Her foreign balances must be available for her use, though no one in India overlooks the fact that their utilisation must be governed by a reasonable understanding with Britain. Above all, the International organisation must recognise that it is not a mere combination of the advanced industrial nations but includes also the undeveloped nations whose needs of capital untainted by political tutelage must be provided for.

On only two of these various points is there some reason for optimism. A recent statement of the Acting Finance Member of the Government of India suggests that Britain will pay off her debt to India in instalments, which will be freely convertible into other currencies and which, if necessary, will be borrowed by her from the Fund. Another point is that the proposals for the International Monetary Fund do afford freedom to member nations to alter their exchange rates. But on other issues, there is still no warrant for pronounced optimism. India recognises that far too much hangs on her political future to make it useful to discuss her place in schemes for international organisations. Her politics to-day is a straight issue between Britain and herself.

But what other foreign nations have to know of India is that in the past she had been successfully baulked of a sound system of currency and exchange, that her industrial development and economic progress were retarded, that her banking system was ill-developed and that on the whole she was ill-fitted either to serve herself or make her proper contribu-

tion to the progress of world economy. If the problems of the post-war period are not mishandled by the Great Powers, India, far from being a sink for the precious metals or a dead-weight to world economy in periods of slump, could help effectively in the efforts of the nations to preserve a smooth-working system of international finance and help world economy and the constituent national economies to higher and higher levels of prosperity. But if India is to succeed in doing that, the outside world must cease to think of her as, economically, a producer of raw material and a market for imports, and, politically, as a mere dependency to be lumped together with the various other parts of the British Empire. India has the resources to manage her currency and exchange in the best interests of her people. But if she is to make her contribution to international financial regulation, she must insist on acting as an independent entity and not as an inconsequential appendage of Great Britain.

